

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

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Federal Communications Commission  
Office of Secretary

In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review	)	CC Docket No. 94-1
for Local Exchange Carriers	)	
	)	
Transport Rate Structure	)	CC Docket No. 91-213
and Pricing	)	

**COMMENTS OF THE NATIONAL CABLE TELEVISION ASSOCIATION**

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The National Cable Television Association ("NCTA"), by its attorneys, submits the following comments in response to the Commission's Notice of Proposed Rulemaking ("NPRM"), FCC 96-488, rel. December 24, 1994, in the above-captioned proceeding.

**I. INTRODUCTION AND SUMMARY**

The outcome of this proceeding is of great importance to NCTA's operator members. The subsidies inherent in the access charge scheme may be used to underwrite uneconomic investments in video and to her competitive services. Without the removal of these subsidies, competition will be undermined. The availability to ILECs of a monopoly base from which to cross-subsidize competitive ventures is of particular concern to the cable industry because virtually all large cable companies and many others are in various stages of planning and deployment of broadband Internet access which will compete with the ILECs' provision of Internet access over the public switched network.

The current access charge scheme will also deter the development of local competition. The cable industry is actively pursuing a variety of strategies to deliver telecommunications services to residential and business customers. In addition, several cable-affiliated companies are also involved in the telecommunications marketplace through Competitive Access Provider ("CAP") and wireless ventures, and may realize economies of scope by offering these services along with video and broadband Internet access. The cable industry participates in this and the related "trilogy" proceedings in support of a regulatory environment that will be conducive to competition in all sectors of the communication marketplace over the long term.

Cable companies seek access charge rules that advance facilities-based competition over the long run:

- The Commission should not reverse a decade-old policy that has enabled information services to develop and flourish by permitting LECs to impose access charges upon information service providers or their customers. Consistent with this approach, the Commission should prohibit, in particular, the imposition of access charges on cable-provided Internet access.
- The LECs have had ample opportunity to recover embedded costs from the multitude of new services they have been permitted to offer in recent years. They will have an even greater opportunity to recover these costs, to the extent they are not already recovered, once they are authorized to offer in-region inter-LATA services. If LECs are permitted to further recover embedded costs from competitors or their customers, competition will be impeded and the risk of over-recovery will be significant.
- The marketplace, by itself, will not bring about facilities-based competition or drive interstate access prices to competitive levels. Despite the market-opening actions already undertaken, the incumbents will continue to exercise market power and will be able to maintain prices above competitive levels.
- The "market-based" approach, one of the key alternatives advanced by the Commission, is inadequate. The Act already requires LECs to satisfy virtually all of the Phase 1 conditions. Even if these conditions are, in the retail interstate access context, satisfied, cost-based rates will not result. LECs should not receive pricing flexibility unless they comply with the Phase 1 conditions, actual competition is present, and consumers are offered interstate access services at cost-based rates.

- The Commission should, therefore, require the reduction of retail interstate access rates to forward-looking cost over a transition period. Reductions of interstate access rates to forward-looking cost is needed if consumers are to obtain the statute's intended objective of cost-based retail rates. A reasonable transition period recognizes the substantial changes in marketplace conditions and cost recovery to which the ILECs are or will be subject.
- Although the market-based approach cannot be relied upon in place of required reductions in retail access charges to forward-looking cost, the elements of Phase 1 should be applied as a condition of pricing flexibility. LECs should not obtain pricing flexibility unless they comply with the Phase 1 conditions initially and on an ongoing basis. The Commission should not include Internet access or video common carriage within the new services classification.
- The Transport Interconnection Charge, which has been found to be unjustified by the Court of Appeals, should be eliminated immediately.
- Rate structures should be revised to reflect cost causation. Traffic sensitive elements should be priced on a usage-sensitive basis; non-traffic sensitive elements should be flat-rated.
- The Commission should also take additional steps to engender rates that reflect costs:
  - Access charges should be reduced to take account of the prior completion of network access reconfiguration;
  - The Commission should maintain regulations allocating costs between regulated and non-regulated services. Prompt action as proposed in CC Docket No. 96-112 is needed to allocate costs between regulated and non-regulated services;
  - Spare capacity deployed for the purpose of offering unregulated services should be excluded from the basis for recalculated price caps; and
  - CLEC-provided terminating access should not be regulated.

These actions are necessary to the successful completion of the Access Charge Reform proceeding. It is upon such a foundation, firm or weak, that entrants such as cable must rely in deciding when and how to enter the local competition for phone service anticipated by the 1996 Telecommunications Act.

## **II. INFORMATION SERVICE PROVIDERS SHOULD NOT BE REQUIRED TO PAY ACCESS CHARGES\***

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The Commission seeks comment on “the narrow question of whether to permit incumbent LECs to assess interstate access charges on information service providers.”<sup>1</sup> It tentatively concludes the existing interstate access pricing structure for information services, which does not impose an access charge on these services, should be maintained. NCTA strongly agrees.

The cable industry is particularly concerned the Commission take no action to impede the development and deployment of broadband cable modem services, such as Internet access delivered by cable modems. The cable modem, once generally deployed, will represent a significant advance in distribution capability, speeding quality graphics, text and sound to personal computers. It’s already making a significant difference where it has been tested and adopted on an early basis. The imposition of a special charge on a competitor’s service, intended to mitigate competitive forces and favor telephone distribution at the expense of broadband cable modem distribution, may impede cable’s exciting new service offering.

The Commission’s initial judgment not to subject information service providers or their customers “to a regulatory system designed for circuit-switched voice telephony”<sup>2</sup> is warranted because one of these services in particular, Internet access, is a fast-developing new service that has captured the imagination of consumers. The demand for Internet access has come out of nowhere to become an integral part of our information society in a very short time.

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\* Responsive to Section VIII.B.

<sup>1</sup> Access Charge Reform, FCC 96-488, rel. Dec. 24, 1996, (“Access Charge Reform”) at ¶283.

<sup>2</sup> Access Charge Reform at ¶288.

Internet access appears, moreover, to be developing in a manner consistent with a competitive market model. The Commission notes the Internet access market is “highly competitive and dynamic,” with more than 2,000 companies offering Internet access as of mid-1996.<sup>3</sup> We share the Commission’s perspective “it is extremely likely that, had per-minute interstate access rates applied to ESPs over the past 13 years, the Internet and other information services would not have developed to the extent they have today -- and indeed may not have developed commercially at all.”<sup>4</sup> At this early stage of Internet development, the last thing the government should do is take actions that effectively create new costs of entry and new entry barriers. Congestion resulting from heavy Internet use may be a temporary phenomenon. Internet demand may inspire manufacturers and network providers to develop more efficient means of managing traffic and delivering services. The Commission should encourage the ILECs to pursue new solutions, rather than sanctioning an unnecessary charge likely to have the unfortunate consequence of dampening Internet demand before the full value to consumers of the service is fully realized.

As the Commission observes, ILECs have argued for many years that information services providers (“ISPs”) “impose costs on the network that are similar to those imposed by providers of interstate voice telephony, and that ISPs should therefore pay interstate access charges.”<sup>5</sup> ISPs counter that the rates they pay to ILECs for telecommunications services,

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<sup>3</sup> Id. at ¶285.

<sup>4</sup> Id.

<sup>5</sup> Id. at ¶286 (citation omitted).

“combined with the additional revenues from sources such as second lines installed for Internet usage, more than covers the costs they impose on the network.”<sup>6</sup> ISPs further point out that “the imposition of access charges would stifle growth, investment, and innovation in information services, causing detrimental effects for the economy and U.S. competitiveness.”<sup>7</sup>

ISPs are correct that access charges should not be imposed on providers of information services. The access charge scheme was implemented to compensate ILECs for the use of their facilities by interexchange carriers and customers. ILECs separately receive compensation for local services and for other network-generated offerings.

The discrete treatment of Internet access is further supported by the Recommended Decision of the Federal-State Joint Board on Universal Service.<sup>8</sup> The Joint Board found that “the provision of Internet access does not meet the statutory definition of ‘telecommunications service.’”<sup>9</sup> Since access charges are imposed to compensate LECs for use of their networks to deliver “telecommunications services,” and, as the Joint Board correctly found Internet access is not a “telecommunications service,” it follows that an access charge should not be imposed on Internet access.

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<sup>6</sup> Id. at ¶287 (citation omitted).

<sup>7</sup> Id. (citation omitted).

<sup>8</sup> Recommended Decision of the Federal-State Joint Board on Universal Service, FCC 96J-3, rel. Nov. 8, 1996 (“Joint Board Decision”).

<sup>9</sup> Id. at ¶69.

The Commission's outstanding Notice of Inquiry on Usage of the Public Switched Network by Information Service and Internet Access Providers,<sup>10</sup> issued concurrently with this NPRM, is the appropriate forum for consideration of the long-term question of whether ISPs, and in particular Internet access providers, should bear some special charge. We believe that proceeding will reach the same result as the Commission's tentative conclusion. For now, the Commission should maintain the *status quo* and not permit ILECs to impose an access charge on information and Internet access services.

**III. INCUMBENT LOCAL EXCHANGE CARRIERS SHOULD NOT BE PERMITTED TO RECOVER EMBEDDED COSTS BY IMPOSING A SPECIAL CHARGE ON COMPETITORS OR THEIR CUSTOMERS\***

The Commission suggests two bases for permitting ILECs to recover interstate allocated embedded costs (not otherwise already recovered or recovered through forward-looking prices). Under one theory, equities created by past regulatory practices entitle ILECs to recover embedded costs irrespective of the changed circumstances. Related to this proposition are the notions that Commission-implemented depreciation practices have prevented ILECs from recovering their investments, and that ILECs are entitled to recovery through some regulatory device. The Commission suggests, for example, that "current depreciation procedures were developed in the 1940's, when there was less technological innovation and no competition in the

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<sup>10</sup> Usage of the Public Switched Network by Information Service and Internet Access Providers, FCC 96-488, rel. Dec. 24, 1996.

\* Responsive to Section VII.B.

telecommunications industry.”<sup>11</sup> If that were true, ILEC plant might be severely underdepreciated, and special recovery treatment might be warranted.

Although it might be strictly correct that the model for telephone company depreciation was “developed” in the 1940’s, the Commission has subsequently taken major steps that have enabled telephone companies to recover their investment at a more rapid rate. As the Commission notes, since the early 1980’s telephone companies have been able to seek depreciation under the “remaining life depreciation methodology instead of whole life methods.”<sup>12</sup> Remaining life techniques permit an ILEC to request depreciation rates “over the expected remaining life.”<sup>13</sup>

Moreover, dramatic changes in the marketplace since the 1940’s have substantially reduced the risk that ILECs facing competition will not be able to recover their embedded costs. The high consumer demand for second lines and enhance services such as call waiting, when combined with revenues ILECs can anticipate once they enter the interexchange market, significantly reduce the risk of under-recovery. Neither changed regulatory conditions in general, or concerns over underdepreciation in particular, warrant the imposition upon competitors or their customers of a charge intended to ameliorate the effects of competition.

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<sup>11</sup> Access Charge Reform at ¶266, n.355.

<sup>12</sup> Id. at ¶251, n.343.

<sup>13</sup> Id. (citation omitted).

**IV. MARKETPLACE AND MARKET-BASED APPROACHES ARE INADEQUATE; THE COMMISSION MUST SUPERVISE THE TRANSITION FROM MONOPOLY TO COMPETITION**

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It would be foolish for the Commission to engage in prescription if market mechanisms were able to drive access rates to cost. Competition is a far more efficient allocator of resources and regulator of prices than government regulation. The Commission has acknowledged such many times over many years, and the NPRM evidences a continued commitment to this proposition. In the case of exchange access, however, there is not sufficient competition to ensure just and reasonable rates. In the absence of effective and efficient Commission oversight, excessive access rates would enable ILECs to subsidize their entry into video and other new markets.

**A. No One Disputes the Goal of Local Telephone Competition; The Only Question Is How To Achieve It\***

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NCTA shares the Commission's goal of a competitive telecommunications marketplace. In contrast to multichannel video services, however, which have encountered increasing competition from multiple sources in recent years,<sup>14</sup> competition to the incumbent local exchange carriers ("ILECs") remains nascent. This is especially true of residential services, where very few consumers have any choices, and the number of consumers with facilities-based alternatives is particularly limited.

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\* Responsive to Section IV.

<sup>14</sup> See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Third Annual Report, FCC 96-496, rel. Jan. 2, 1997.

The Telecommunications Act of 1996 established a national policy in favor of local competition. The ILECs are directed for the first time to open their bottleneck monopolies to competitors. ILECs are required to interconnect with competitors under just and reasonable terms. They are also obliged to unbundle their networks, providing competitors with the option of combining their facilities with components of the incumbent's network. Resale arrangements are also required. Many business practices previously employed by ILECs to inhibit competition are made illegal.

Congress recognized in passing the legislation that prohibiting statutory monopolies and adopting provisions intended to open markets to competition would not, by themselves, turn the goal of competition into a reality. It directed the Commission to conduct implementation proceedings, the most significant of which are the Local Competition and Universal Service proceedings. It also directed the states to supervise the interconnection agreement proceedings, and to maintain their role in overseeing the intrastate component of end-user rates.

It is now more than eleven months since enactment of the new law. The Local Competition and related orders have been adopted by the Commission and have been appealed by many of the largest ILECs. The Universal Service Joint Board has issued its Recommended Decision, and a final decision is due shortly. States have issued arbitration decisions, and many of these are on appeal. Ameritech has filed the first application under Section 271 to obtain authority to offer inter-LATA services within its region, and many others are expected soon. In short, the regulatory and appellate processes are well underway.

But competition is not well underway. Consumers still lack the choices envisioned by the Act and the Local Competition Order.<sup>15</sup> There are several explanations. First, competition takes time. There was a more than thirty year period between MCI's first long distance application and the declaration that AT&T was no longer dominant, so, too, will there be a significant period between the first local authorizations and future declarations that ILECs are nondominant.

Second, there is a natural process in which competitive businesses plan, but are slow to invest until the government makes the rules clear.

Third, as NCTA emphasized in its comments in Local Competition, excessive resale discounts tend to inhibit facilities-based competition.<sup>16</sup>

Fourth, companies are in the process of reevaluating business strategies in light of constantly changing regulatory and marketplace conditions and the status of technological developments.

Finally, and perhaps most important, firms entering the historically monopolized local exchange market can expect to encounter challenges from the incumbent using its monopoly assets. Indeed, the LECs appear to have chosen to use regulation and judicial review to challenge competition at every turn. The appeal of the Local Competition Order, and GTE's numerous appeals of State arbitration decisions underscore the point that until actual competition exists, there are no "marketplace forces" at work

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<sup>15</sup> Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, FCC 96-325, rel. Aug. 8, 1996 ("Local Competition Order").

<sup>16</sup> Comments of the National Cable Television Association, CC Docket No. 96-98, May 16, 1996, at 57.

**B. Competition Will Not Be Realized If Matters Are Left To The Marketplace\***

In these circumstances, a marketplace solution will not cut the mustard. Heroic steps have already been taken to open the market to competition. The Act removed the government-conferred monopolies that the ILECs have enjoyed formally for nearly a century. But the regulatory elimination of statutory monopolies alone does not in itself mean competition can take hold. Nor does it mean consumers will have a real choice that results in downward pressure on prices.

This is apparent from an analysis of what an ILEC is required to do as a result of the legislation. Congress felt it necessary to take steps, further elaborated upon by the Commission in the Local Competition Order, to reduce and eliminate entry barriers. It directed ILECs, among other things, to interconnect with competitors on equal terms, to offer unbundled network access and resale, to establish reciprocal compensation arrangements, to offer number portability, dialing parity and access to public rights of way, and to ensure access by competitors to telephone numbers.<sup>17</sup> Congress also mandated the interconnection agreement negotiation and arbitration processes which have resulted in detailed contractual arrangements between competitors over the terms of competition, and a state review in those cases where private parties cannot reach agreement.

In response, private parties have engaged in months of work to iron out the details of their relationships. Federal and state regulators have devoted extraordinary resources to meet

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\* Responsive to Section IV.

<sup>17</sup> See 47 U.S.C. § 251(c).

statutory deadlines. The federal courts have begun their part of the review process, and that is sure to consume significant resources. In short, the major processes envisioned by the Act are underway and are in various stages of completion.

But these critical (and far from completed) market-opening steps, and the attendant private contractual, regulatory and judicial review processes, no matter how successful, will not by themselves achieve Congress' competitive vision if the ILECs are able to indefinitely maintain interstate access prices significantly above cost. So long as there are virtually no facilities-based alternatives, access providers will be reliant upon ILEC facilities to complete their calls. Thus, ILECs have no market-based incentive to reduce their excessive access charges to competitors unless they face viable facilities-based competition in the local loops.

Section 201 of the Communications Act directs the Commission to maintain just and reasonable telephone charges, classifications, practices and regulations. The 1996 Act similarly requires interconnection "on rates, terms and conditions that are just, reasonable, and nondiscriminatory."<sup>18</sup> Until the telecommunications marketplace or particular services within that marketplace are competitive, "just and reasonable" interstate access charges cannot be achieved and maintained without continuing regulatory oversight.

**C. Competition Will Not Be Advanced Under The "Market-Based" Approach To Access Charge Reform\***

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The Commission asks for comment on an approach to achieve retail competition in interstate access services that it characterizes as "market-based." This contrasts with

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<sup>18</sup> 47 U.S.C. § 251(c)(2)(D).

\* Responsive to Section V.

“marketplace” regulation, which in our view is proper only when an ILEC faces “substantial competition” such that it is no longer able to unilaterally impact the price of a service.<sup>19</sup> Under the market-based alternative, the ILEC will continue to exercise substantial market power indefinitely. Moreover, implementation of the market-based approach instead of “prescription” is likely to delay indefinitely the consumer benefit associated with competition. As such, although this approach has advantages, and the term “market” is in its “name,” the market-based approach for the foreseeable future will be no more “marketplace” than silver plate is the same thing as sterling silver.

The Commission proposes three phases to its market-based approach. Under Phase One, an ILEC obtains four types of pricing flexibility (limited geographic deaveraging, the ability to offer volume and term discounts, the ability to offer contract tariffs and deregulation of “new services”) if it satisfies eight criteria. Where it is demonstrated on a service-by-service basis that the firm faces “actual competition,” additional pricing flexibility will be provided. The company’s service offering will be deregulated when it faces “substantial competition.”

NCTA opposes the employment of the market-based approach as proposed, because it does not calibrate pricing flexibility to the presence of actual competition and reductions of access charges to forward-looking cost. Rather, it offers ILECs the prospect of substantial

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<sup>19</sup> Access Charge Reform at ¶149. (“Once substantial competition is present for a particular service in a particular area, we propose to remove that service from price cap and tariff regulation for that area.”) The Commission proposes to take these steps irrespective of the regulatory approach selected in the Access Charge Reform proceeding. NCTA agrees that once an ILEC service is subject to substantial competition, defined as a condition in which the once-dominant carrier is no longer able to unilaterally influence the price at which a service is offered, it should be removed from price cap and tariff regulation.

pricing flexibility in circumstances of what is improperly called “potential competition.” Under the proposed version of potential competition, no actual competition may be experienced, and access rates may remain at supra-competitive levels.

The misnamed market-based approach is particularly problematic because the Phase 1 criteria do not generally constitute new or additional requirements imposed as a trade-off in exchange for pricing flexibility. Rather, the Phase 1 criteria constitute obligations to which BOCs in particular are already subject. In this sense, Phase 1 can be interpreted as a proposal to grant ILECs pricing flexibility merely because the Telecommunications Act has become law.

This can be demonstrated from a comparison of statutory provisions and comparable Phase 1 conditions:

- Under the first Phase 1 condition, “unbundled network element prices are based on geographically deaveraged, forward-looking economic costs in a manner that reflects the way costs are incurred.”<sup>20</sup> Section 251(c)(3) requires ILECs to provide “nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory” in accordance with, *inter alia*, Section 251.<sup>21</sup> Section 201 requires “just and reasonable” dominant interstate carrier rates.<sup>22</sup> Since the Commission has interpreted “just and reasonable” to require rates for unbundled elements at “forward-looking cost,” it follows that ILECs are already required to offer and price unbundled elements at forward-looking cost.
- Second, the Commission proposes to grant Phase 1 relief “if transport and termination charges are based on the additional cost of transporting and terminating another carrier’s traffic.”<sup>23</sup> Section 251(b)(5) requires ILECs “to establish reciprocal compensation arrangements for the transport and

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<sup>20</sup> Access Charge Reform at ¶163(1).

<sup>21</sup> 47 U.S.C. § 251(c)(3).

<sup>22</sup> 47 U.S.C. § 201.

<sup>23</sup> Access Charge Reform at ¶163(2)(3).

termination of telecommunications.”<sup>24</sup> Section 252 (d)(2)(A)(ii) requires pricing of transport and termination at “additional costs.”<sup>25</sup>

- The Commission proposes to trigger Phase One where “wholesale prices for retail services are based on reasonably avoidable costs.”<sup>26</sup> Third, Section 252 requires ILECs to make retail services available at costs that “will be avoided.”<sup>27</sup> The Section 271 checklist calls upon BOCs to make telecommunications services available for resale, in accordance with Sections 251 and 252, at wholesale rates based on costs that “will be avoided.”<sup>28</sup>
- Fourth, the Commission proposes to require that “network elements and services are capable of being provisioned rapidly and consistent with a significant level of demand.”<sup>29</sup> Section 251(c)(3) requires ILECs to provide unbundled elements in a manner that allows requesting carriers to offer service.<sup>30</sup>
- Fifth, the Commission proposes to trigger Phase 1 relief when “dialing parity is provided by the incumbent LEC to competitors.”<sup>31</sup> Section 251(c)(3) compels ILECs to offer local dialing parity to competitors, and the Section 271 checklist requires the offering of “local dialing parity in accordance with the requirements of section 251(c)(3).”<sup>32</sup>
- Sixth, the Commission proposes to condition Phase 1 relief on the provision of “number portability ... by the incumbent LEC to competitors.”<sup>33</sup> Section 251 (b)(2) calls for number portability and the Section 271 checklist mandates

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<sup>24</sup> 47 U.S.C. §251(b)(5).

<sup>25</sup> 47 U.S.C. §252(d)(2)(A)(ii).

<sup>26</sup> Access Charge Reform at ¶163.

<sup>27</sup> 47 U.S.C. §252(d)(3).

<sup>28</sup> 47 U.S.C. §§ 271(c)(2)(xiv), 251(c)(4), 252(d)(3)(xiv).

<sup>29</sup> Access Charge Reform at ¶163(4).

<sup>30</sup> 47 U.S.C. § 251(c)(3).

<sup>31</sup> Access Charge Reform at ¶163(5).

<sup>32</sup> 47 U.S.C. § 271(c)(2)(B)(xii).

<sup>33</sup> Access Charge Reform at ¶163(6).

the provision by the BOCs of “number portability” in accordance with regulations issued in accordance with Section 251.<sup>34</sup>

- Seventh, the Commission proposes to provide Phase 1 relief if “access to incumbent LEC rights-of-way is provided to competitors.”<sup>35</sup> Section 251(b)(4) requires carriers to provide “access to the poles, ducts, conduits and rights-of-way ... to competing providers of telecommunications services on rates, terms, and conditions that are consistent with Section 224.”<sup>36</sup>
- Finally, the Commission proposes to require as a condition of Phase 1 relief that “open and nondiscriminatory network standards and protocols are put into effect.”<sup>37</sup> Section 251 (c)(3) requires an ILEC to “provide ... unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service.”<sup>38</sup> “Network element” is defined to include, in addition to facilities and equipment, “features, functions and capabilities that are provided by means of such facilities or equipment.”<sup>39</sup> Network “features, functions and capabilities” presumably include network protocols. Section 273(c) directs the BOCs to maintain and file with the Commission, in accordance with Commission regulations, “full and complete information with respect to the protocols and technical requirements for connection with and use of its telephone exchange service facilities.”<sup>40</sup>

In considering retail “pricing flexibility” for ILECs, the Commission should proceed cautiously because the ILECs, in contrast to all other providers of communications today, retain bottleneck control over an essential facility and a market share in the upper reaches of the ninetieth percentile. The Commission proposes certain types of retail pricing flexibility --

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<sup>34</sup> 47 U.S.C. § 271(c)(2)(B)(xi).

<sup>35</sup> Access Charge Reform at ¶163(7).

<sup>36</sup> 47 U.S.C. § 251(b)(4).

<sup>37</sup> Access Charge Reform at ¶163(8).

<sup>38</sup> 47 U.S.C. § 251(c)(3).

<sup>39</sup> 47 U.S.C. § 153(29).

<sup>40</sup> 47 U.S.C. § 273(c).

limited geographical deaveraging, volume and term discounts, contract tariffs and deregulation of new services -- <sup>41</sup>for ILECs satisfying eight conditions precedent that, collectively, are claimed to constitute a condition of “potential competition.”

As demonstrated above, Congress imposed the elements of the Commission’s “potential competition” test as requirements of wholesale interconnection agreements between ILECs and CLECs. The Act does not suggest at all that in exchange for entering into these agreements ILECs become entitled to any of the forms of retail pricing flexibility contemplated here. To the contrary, the Act imposes the requirement for “good faith” negotiations without according ILECs any *quid pro quo*. It certainly does not contemplate that ILECs complying with these requirements will *automatically* receive pricing flexibility.

The “market-based” proposal assumes that satisfaction of the enumerated elements creates conditions of “potential competition.” In the antitrust context, “potential competition” is a term of art connoting an actual competitive impact resulting directly from the prospect, not yet realized, of potential entry.<sup>42</sup> “Potential competition” as put forth in the NPRM does not include an actual impact on retail consumers as one of its constituent elements. This contrasts with the condition of the multichannel video marketplace. There retail subscribers have actual choices, cable companies face actual competition from multiple sources, and the cable share has below 90 percent. Similar, in the interexchange market, AT&T’s once dominance has declined to the point

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<sup>41</sup> NCTA opposes “new services” pricing flexibility to the extent “video common carriage” or Internet access are classified as “new services.” In contrast o other new services, these services raise issues of profound policy significance and require close regulatory scrutiny.

<sup>42</sup> Federal Trade Commission v. Proctor & Gamble, 386 U.S. 568, 581 (1967) (presence of potential entrant “at the edge of the industry exerted considerable influence on the market”).

where they have been declined nondominant, again due to actual competition. The Commission might more accurately characterize the circumstance where the Phase 1 conditions are satisfied as creating a state of “possible competition.” The particular types of proposed local telephone company pricing flexibility are not justified by a showing local telephone competition is merely possible.

**D. The Market-Based Approach, By Itself Will Not Achieve the Commission’s Objectives\***

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It follows from Section 201’s requirement of “just and reasonable” interstate “charges, practices, classifications and regulations,” and Section 254 (e)’s requirement for “explicit” universal service support, that the “implicit” subsidies incorporated into the existing access charge scheme must be eliminated.<sup>43</sup> Toward that end, the Commission properly identifies the “overriding goal” of this proceeding as the adoption of access charge service rule revisions “that will foster competition for these services and eventually enable marketplace forces to eliminate the need for price regulation of these services.”<sup>44</sup>

**1. The Marketplace Cannot Be Relied Upon to Achieve Cost-Based Prices**

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As explained in the next section, NCTA supports the imposition of the market-based factors as a condition of pricing flexibility. The market-based approach is not a legitimate policy

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\* Responsive to Section VI.

<sup>43</sup> Id. at ¶37.

<sup>44</sup> Id. at ¶145.

alternative to reducing access charges, however. The posited logical link does not hold between satisfaction of the market-opening conditions and pressure to price competitively. ILECs could satisfy the Phase 1 conditions, but continue to exercise monopoly pricing power.

This circumstance will be a natural outgrowth of anticipated disjunctions between theory and practice. Theory suggests the legally mandated availability of unbundled elements at forward-looking cost will result in a “ubiquitous substitute” for access service, and by purchasing the substitute requesting carriers will be able to compete on a level playing field. Practice teaches that the incumbent carriers will have strong incentives upon which they will act to delay the delivery of essential network elements and to use advantages of their monopoly to disadvantage competitors. The Phase 1 condition by which “network elements and services are capable of being provisioned rapidly and consistent with a significant level of demand,”<sup>45</sup> for example, provides no sanction if, notwithstanding the capability, it turns out the network elements provided to a competitor are delivered less promptly and efficiently, and the customer, noticing the difference, retains the incumbent’s service. There are also serious questions regarding the availability at reasonable prices of network elements accessible in a manner that enables a competitor to efficiently deliver an end-to-end service. Only facilities-based competition, not the retail price offered by a reseller or a purchaser of unbundled network elements, can provide a marketplace test of the price supplied by the incumbent.

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<sup>45</sup> Id. at ¶163(4).

**2. Access Charges Should Be Reduced To Forward-Looking Cost Over a Transition Period**

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Access charges should be adjusted eventually to forward-looking cost. The marketplace alone, even if aided by the market-based approach, will not achieve the needed results. To achieve pricing at economic cost, the Commission should determine the difference between existing rates and rates consistent with forward-looking cost. While this task may be administratively burdensome, it is a necessary consequence of the Act. To permit time for appropriate adjustments, and to avoid rate shock, the Commission should incorporate a reasonable transition period into its plan.

The preferred option, pending review of the comments, appears to be the Commission's plan to require incumbent LECs, over a transition period, "to reduce their PCIs by an amount equivalent to the difference between their current PCIs and the TSLRIC revenues of providing the service in each basket."<sup>46</sup> The differential would be determined by conducting a TSLRIC-based study, and comparing the results with the price cap index associated with each service. The "X-factor" could be increased over a period of years until prices were consonant with forward-looking costs.<sup>47</sup>

Price caps are, of course, based upon actual prices, while a TSLRIC study would require a study to determine prospective (i.e., total service long run incremental) costs. By suggesting a calculation of "TSLRIC revenues," we assume the Commission to be proposing a study of prospective costs that could then be translated into prices resulting in reinitialized PCIs. This

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<sup>46</sup> Id. at ¶223.

<sup>47</sup> Id. at ¶232.

arrangement would presumably involve the determination of basket prices sufficient to cover TSLRIC, an appropriate amount allocated to forward-looking common costs, and a reasonable profit. The specific mechanics of this approach would have to be worked out.

The Commission acknowledges the potentially valuable expertise of the states in the conduct of TSLRIC studies. The Commission suggests that under Section 410(a) of the Communications Act,<sup>48</sup> it could implement an approach in which states conducted cost studies upon which the agency would rely to determine the differential between embedded and forward-looking cost.<sup>49</sup> It is further suggested that federal guidelines might be applied to the cost studies the states undertake.

The states' expertise in this area is clear, but the Commission's legal authority is not. The Commission's jurisdiction over interstate access rates is exclusive, and may not be delegated. Although Section 410(a) authorizes the Commission to consult with a Federal-State Joint Board over matters of joint federal-state concern, it is not at all apparent that the Commission has any statutory discretion to either tell or ask an individual state to conduct a cost study the purported purpose of which is to aid in the determination of interstate rates. Just as the Commission's authority to mandate state studies of interstate rates is at best uncertain, its authority to adopt federal guidelines for states conducting interstate rate cost studies is also unclear. The Commission should further explain and justify its proposal or decline to adopt it.

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<sup>48</sup> 47 U.S.C. §410(a).

<sup>49</sup> Id. at ¶224.